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No. 384

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1949.

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

CHRISTIAN W. KORELL,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR RESPONDENT IN OPPOSITION.

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Opinions Below.

The opinion of the Tax Court of the United States (R. 9-14) is reported in 10 T. C. 1001. The initial opinion of the Court of Appeals (R. 16-21) and the opinion on re-hearing (R. 31-32) have not yet been reported.

Jurisdiction.

The judgment of the Court of Appeals was entered June 8, 1949 (R. 21). A petition for re-hearing was denied July 14, 1949 (R. 32-33). The petition for a writ of certiorari was filed October 11, 1949. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

Question Presented.

Did the Tax Court and the Court of Appeals properly allow the deduction claimed by respondent in computing his net income for 1944 under Sections 23(v) and 125 of the Internal Revenue Code for amortization of the premium paid upon the purchase in that year of certain American Telephone and Telegraph Company 15-year, three percent convertible debenture bonds?

Statute and Regulations Involved.

The provisions of the Internal Revenue Code and Treasury Regulations involved are set forth in the Appendix, *infra*, page 5.

Statement.

The facts were stipulated in the Tax Court (R. 2-9) and the summarization thereof and the statement of the case contained in the petition for the writ (pp. 3-6) are not controverted.

Reasons for Denying the Writ.

(1) The Court of Appeals in affirming the unanimous decision of the Tax Court properly followed the plain language of the statute and correctly held that respondent was entitled to amortize the premium paid on the bonds here involved.

Section 125 of the Internal Revenue Code defines "bond premium" in precise and unambiguous terms. It sets forth with equal precision and clarity the method for determin-

ing the amount of bond premium "amortizable" in the taxable year.

In his 1944 return respondent deducted as "amortizable bond premium" an amount of $8,638.75, representing the difference between $60,638.75, the cost of the bonds and $52,000, the price at which the bonds were callable in 1944 (R. 3).

The Commissioner concedes that respondent correctly computed the amount of the premium in accordance with the statutory method. Nevertheless, he asserts that the amount so computed and amortized is not "true" bond premium (R. 19, 20, 30), and urges that the only premium entitled to amortization is that which represents an amount paid to obtain a higher rate of interest (R. 29).

The court below repudiated the Commissioner's contention as narrow and unfair (R. 20), resting its decision on the firm ground that to read any such narrow distinction into Section 125 would be "trespassing beyond the judicial, and upon the legislative, process" (R. 21).

(2) It is beyond question that the conflict between the decision in this case and that of the Court of Appeals for the Ninth Circuit in *Commissioner* v. *Shoong*[1] is the result of the assumption by the latter court of powers reserved to the legislature in disregard of the rule that a court may not legislate by engrafting additions upon a statute to effect a purpose which does not appear on its face or from its legislative history.[2]

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[1] Decided September 9, 1949 (1949 P-H Federal Tax Service, par. 72,593).

[2] *Matson Navigation Co.* v. *United States*, 284 U. S. 352, 356; *Corona Coal Co.* v. *United States*, 263 U. S. 537, 540.

See also:

United States v. *Cooper Corp.*, 312 U. S. 600, 605; *McClain* v. *Commissioner*, 311 U. S. 527, 530.

A conflict of this nature should not provide the occasion for a review of the decision of the Court of Appeals for the Second Circuit, which is plainly in accord with law.

(3) The entire issue of [redacted] involved herein has been called for payment under the provisions of the indenture (R. 3). Therefore, the question of whether it is proper to amortize the premium paid upon the purchase of these bonds is not of general and continuing importance.

Conclusion.

The petition for a writ of certiorari to review the decision of the Court of Appeals for the Second Circuit should be denied.

Dated: New York, N. Y., November 17, 1949.

Respectfully submitted,

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Appendix.

Internal Revenue Code:

SEC. 23 DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

• • • • • •

(v) [as added by Sec. 126 of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Bond Premium Deduction.*—In the case of a bondholder, the deduction for amortizable bond premium provided in section 125.

• • • • • •

(26 U. S. C. 1946 ed., Sec. 23.)

SEC. 125 [as added by Sec. 126 of the Revenue Act of 1942, *supra*]. AMORTIZABLE BOND PREMIUM.

(a) *General Rule.*—In the case of any bond, as defined in subsection (d), the following rules shall apply to the amortizable bond premium (determined under subsection (b) on the bond for any taxable year beginning after December 31, 1941:

(1) *Interest wholly or partially taxable.*—In the case of a bond (other than a bond the interest on which is excludible from gross income), the amount of the amortizable bond premium for the taxable year shall be allowed as a deduction.

(2) *Interest wholly tax-exempt.*—In the case of any bond the interest on which is excludible from gross income, no deduction shall be allowed for the amortizable bond premium for the taxable year.

(3) *Adjustment of credit in case of interest partially tax-exempt.*—In the case of any bond the interest on which is allowable as a credit against net income, the credit provided in section 25(a) (1) or (2), or section 26(a), as the case may be, shall be reduced by the amount of the amortizable bond premium for the taxable year.

(For adjustment to basis on account of amortizable bond premium, see section 113(b) (1) (H).)

(b) *Amortizable Bond Premium.*—

(1) *Amount of bond premium.*—For the purposes of paragraph (2), the amount of bond premium, in the case of the holder of any bond, shall be determined with reference to the amount of the basis (for determining loss on sale or exchange) of such bond, and with reference to the amount payable on maturity or on earlier call date, with adjustments proper to reflect unamortized bond premium with respect to the bond, for the period prior to the date as of which subsection (a) becomes applicable with respect to the taxpayer with respect to such bond.

(2) *Amount amortizable.*—The amortizable bond premium of the taxable year shall be the amount of the bond premium attributable to such year.

(3) *Method of determination.*—The determinations required under paragraphs (1) and (2) shall be made—

(A) in accordance with the method of amortizing bond premium regularly employed by the holder of the bond, if such method is reasonable;

(B) in all other cases, in accordance with regulations prescribing reasonable methods of amortizing bond premium, prescribed by the Commissioner with the approval of the Secretary.

(c) *Election on Taxable and Partially Taxable Bonds.*—

(1) *Eligibility to elect and bonds with respect to which election permitted.*—This section shall apply with respect to the following classes of taxpayers with respect to the following classes of bonds only if the taxpayer has elected to have this section apply.

(A) *Partially Tax-Exempt.*—In the case of a taxpayer other than a corporation, bonds with respect to the interest on which the credit provided in section 25(a) (1) or (2) is allowable; and

(B) *Wholly Taxable.*—In the case of any taxpayer, bonds the interest on which is not excludible from gross income but with respect to which the credit provided in section 25(a) (1) or (2), or section 26(a), as the case may be, is not allowable.

(2) *Manner and effect of election.*—The election authorized under this subsection shall be made in accordance with such regulations as the Commissioner with the approval of the Secretary shall prescribe. If such election is made with respect to any bond (described in paragraph (1)) of the taxpayer, it shall also apply to all such bonds held by the taxpayer at the beginning of the first taxable year to which the election applies and to all such bonds thereafter acquired by him and shall be binding for all subsequent taxable years with respect to all such bonds of the taxpayer, unless, upon application by the taxpayer, the Commissioner permits him, subject to such conditions as the Commissioner deems necessary, to revoke such election. The election authorized under this subsection in the case of a member of a partnership shall be exercisable with respect to bonds of the partnership only by the partnership. In the case of bonds held by a common trust fund, as defined in section 169, or by a foreign personal holding company, as defined in section 331, the election authorized under this subsection shall be exercisable with respect to such bonds only by the common trust fund or foreign personal holding company.

(d) *Definition of Bonds.*—As used in this section, the term "bond" means any bond, debenture, note, or certificate or other evidence of indebtedness, issued by any corporation and bearing interest (including any like obligation issued by a government or political subdivision thereof), with interest coupons or in registered form, but does not include any such obligation which constitutes stock in trade of the taxpayer or any such obligation of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or any such obligation held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business (26 U. S. C. 1946 ed., Sec. 125).

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.125-1. *In General.*—(a) *Application.*—Section 125 makes provision for the amortization of bond premium by the owners of the bonds. It is mandatory with respect to—

* * * * *

It is optional, at the election of the taxpayer, with respect to—

(1) fully taxable bonds (the interest on which is subject to normal tax and surtax), whether the owner is a corporation, individual, or other taxpayer; and

(2) partially tax-exempt bonds owned by taxpayers other than corporations.

The term "bond" as used in section 125 means any bond, debenture, note, or certificate or other evidence of indebtedness, issued by any corporation and bearing interest (including any like obligation issued by a government or political subdivision thereof), with interest coupons or in registered form, but does not include any such obligation which constitutes stock in trade of the taxpayer or any such obligation of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or any such obligation held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. Since bonds owned by dealers in securities are excluded from the foregoing definition, section 125 has no application to such dealers.

(b) *Operation.*—In the case of a fully tax-exempt bond, the amortizable bond premium for the taxable year is simply an adjustment to the basis or adjusted basis of the bonds. Thus, if such premium is $1, the basis or adjusted basis of the bond is reduced by $1. No deduction is allowable on account of such amortizable bond premium. In the case of a fully taxable bond to which section 125 is applicable, the amortizable bond premium is both an adjustment to the basis or adjusted basis of the bond and a deduction.

* * * * * *

SEC. 29.125-2. *Bond Premium and Amortizable Bond Premium.*—Bond premium on any bond to which section 125 applies is the excess of the amount of the basis (for determining loss on sale or exchange) of the bond over the amount payable at maturity or, in the case of a callable bond, earlier call date. (For determination of applicable call date see section 29.125-5.) If the date as of which such basis of the bond was established precedes the first taxable year with respect to which such section applies to the bond, there shall be made adjustments proper to reflect unamortized bond premium on such bond for the

period including the holding period (as determined under section 117 (h)) prior to the date as of which section 125 first becomes applicable to the bond in the hands of the taxpayer.

* * * * * * *

Amortizable bond premium on any bond to which section 125 applies is such part of the bond premium on the bond as is attributable to the taxable year.

SEC. 29.125-3. *Methods of Amortization.*—The determinations of the bond premium and amortizable bond premium on any bond to which section 125 applies shall be made in accordance with:

(a) the method of amortization regularly employed by the taxpayer, if such method is reasonable; or

(b) the method of amortization prescribed by this section.

A method of amortization will be deemed "regularly employed" by a taxpayer if the method was consistently followed in taxable years beginning prior to January 1, 1942, or if for taxable years beginning on or after such date the taxpayer (including a taxpayer who followed a different method in taxable years beginning prior to January 1, 1942) initiates in the first taxable year for which the deduction is taken a reasonable method of amortization and consistently follows such method thereafter. A taxpayer who regularly employs a method of amortization may be one, for example, who is subject to the jurisdiction of a State or Federal regulatory agency and who, for the purposes of such agency, amortizes the bond premium on his bonds in accordance with a method prescribed or approved by such agency. However, it is not necessary that the taxpayer be subject to the jurisdiction of such an agency or that the method be prescribed or approved by such agency. It is sufficient if the taxpayer regularly employs a method of amortization and if such method is reasonable.

The method of amortization prescribed by this section is as follows:

(1) The bond premium on any bond to which section 125 applies shall be determined in accordance with section 29.125-2 and shall be computed as of the end of the taxable year (or as of the date of disposition

or redemption of the bond, if it was disposed of or redeemed in the taxable year) but without regard to the amortizable bond premium for the taxable year; and

(2) The amortizable bond premium on such bond for the taxable year shall be an amount which bears the same ratio to the bond premium on the bond as the number of months in the taxable year during which the bond was owned by the taxpayer bears to the number of months from the beginning of the taxable year (or, if the bond was acquired in the taxable year, from the date of acquisition) to the date of maturity or earlier call date. For the purposes of this section a fractional part of a month shall be disregarded unless it amounts to more than half a month in which case it shall be considered as a month.

SEC. 29.125-4. *Election.*—In the case of a corporation, the election provided in section 125 may be made only with respect to fully taxable bonds. In the case of a taxpayer other than a corporation, the election provided in such section may be made with respect to (a) fully taxable bonds only, or (b) partially tax-exempt bonds only, or (c) both fully taxable bonds and partially tax-exempt bonds. Such election shall be made by the taxpayer by claiming a deduction for the bond premium in his return for the first taxable year to which he desires the election to be applicable. No other method of making such election is permitted. If the election is so made, the taxpayer should attach to his return a statement showing the computation of the deduction. The election shall apply to all bonds in respect of which it was made owned by the taxpayer at the beginning of the first taxable year to which the election applies and also to all bonds of such class (or classes) thereafter acquired by him, and shall be binding for all subsequent taxable years. Upon application by the taxpayer, the Commissioner may permit him to revoke the election, subject to such conditions as the Commissioner deems necessary. • • •

SEC. 29.125-5. *Callable and Convertible Bonds.*—The fact that a bond is callable or convertible into stock does not, in itself, prevent the application of section 125. For the purposes of such section, in the case of a callable bond the earlier call date will be considered as the maturity date and the amount due on such date will be considered

as the amount payable on maturity, unless the taxpayer regularly employs a different method of amortization which is reasonable. Hence, the bond premium on such a bond is required to be spread over the period from the date as of which the basis for loss of the bond is established down to the earlier call date, rather than the maturity date. The earlier call date may be the earliest call date specified in the bond as a day certain, the earliest interest payment date if the bond is callable at such date, the earliest date at which the bond is callable at par, or such other call date, prior to maturity, specified in the bond as may be selected by the taxpayer. A taxpayer who deducts amortizable bond premium with reference to a particular call date may not thereafter use a different call date in the calculation of amortization deductions with respect to such premium. A convertible bond is within the scope of section 125 if the option to convert on a date certain specified in the bond rests with the holder thereof.